

DEPARTMENT OF STATE REVENUE

Revenue Ruling #IT 98-06

October 20, 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

1. Income Tax – S Corporation Exemption From Gross Income Tax

Authority: IC 6-3-2-2.8(2), IC 6-2.1-3-24, IC 6-3-8-5, IC 6-3-7-1

The taxpayer requests the Department to rule on the exemption from gross income tax for an S corporation whose shareholder is not subject to adjusted gross income tax.

2. Income Tax – Adjusted Gross Income Tax Withholding by an S Corporation

Authority: IC 6-3-4-13, Income Tax Information Bulletin #85, 1997 S Corporation Income Tax Booklet, IRC Section 401(a), IC 6-3-2-2.8(1), Rule 45 IAC 3.1-1-7

The taxpayer requests the Department to rule on the requirements for withholding adjusted gross income tax by an S corporation.

STATEMENT OF FACTS

The taxpayer is a Delaware Corporation headquartered in Chicago. The taxpayer is a manufacturer that has three plants in Indiana. The taxpayer is owned entirely by an Employees' Stock Ownership Plan, hereinafter "ESOP". The ESOP is a nonresident of Indiana.

Presently, the taxpayer is taxed as a C corporation for federal income tax purposes. Its taxable year ends September 30. The taxpayer has elected under Section 1362(a) of the Internal Revenue Code to be taxed for federal income tax purposes as an S corporation effective October 1, 1998.

The ESOP (a "qualified trust" under Section 401(a) of the IRC) is generally exempt from federal income tax [IRC Section 501(a)]. The ESOP is subject to federal income tax only on its "unrelated business taxable income" as defined in Internal Revenue Code Section 512. It is presently contemplated that the ESOP will not have any "unrelated business taxable income", therefore, will have no income that is subject to federal or Indiana income tax [IC 6-3-2-2.8(1), IC 6-2.1-3-22 and IC 6-3-8-5].

ISSUE #1 – DISCUSSION

The taxpayer, as an S corporation, is exempt from gross income tax, adjusted gross income tax and supplemental net income tax with certain exemptions [IC 6-3-2-2.8(2), IC 6-2.1-3-24 and IC 6-3-8-5] and for this discussion is considered to be exempt from all Indiana income taxation.

IC 6-3-7-1 provides;

In the event the tax imposed by IC 6-3-1 through IC 6-3-7 (adjusted gross income tax) is held inapplicable or invalid with respect to any person, or the shareholders of any corporation described in IC 6-3-2-2.8(2), or the partners of any such partnership, then notwithstanding IC 6-2.1-3-23 or IC 6-2.1-3-24 such person or such corporation or such partnership shall be liable for the tax on gross income as imposed by IC 6-2.1 for the taxable periods with respect to which the tax imposed by IC 6-3-1 through IC 6-3-7 (adjusted gross income tax) is held inapplicable or invalid.

In the instant case, does IC 6-3-7-1 impose gross income tax on the taxpayer because the ESOP (sole shareholder of the taxpayer) is not subject to adjusted gross income tax? No, the taxpayer is not subject to gross income tax as a result of the ESOP not being subject to adjusted gross income tax. IC 6-3-7-1 is applicable only if adjusted gross income tax does not apply to the ESOP by reason of a ruling by a court of law or an administrative agency. If adjusted gross income tax does not apply to the ESOP due to an express statutory exemption [IC 6-3-2-2.8(1)], IC 6-3-7-1 is not applicable, and the taxpayer is not subject to gross income tax.

ISSUE #1 – Ruling

The Department rules that if the ESOP is exempt from adjusted gross income tax by virtue of an express statutory exemption the taxpayer will not be subject to gross income tax under IC 6-3-7-1.

ISSUE #2 – DISCUSSION

IC 6-3-4-13 provides that every corporation which is exempt from tax under IC 6-3 pursuant to IC 6-3-2-2.8(2) (S corporations) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the Department. "Income Tax Information Bulletin #85", interpreting IC 6-3-4-13, states that S corporations are to withhold adjusted gross income tax from income distributions or credits made to a nonresident trust that passes through the income to nonresident beneficiaries (the ultimate recipients). The S corporation is to designate the nonresident beneficiaries as "nominee" recipients who then may claim the withheld Indiana adjusted gross income tax. The "1997 S Corporation Income Tax Booklet" echoes "Information Bulletin #85" by stating, "An S corporation must withhold tax from income distributions to a fiduciary passing through Indiana income to a nonresident beneficiary and designate as a "Nominee" the ultimate recipient as if there was no intermediary entities."

Here, the taxpayer has a nonresident "qualified" (Section 401(a) of the IRC) ESOP as its sole shareholder. The ESOP does not "pass through" the distributions and/or credits from the taxpayer to its beneficiaries nor are the distributions and/or credits taxable for adjusted gross income tax purposes to the ESOP [IC 6-3-2-2.8(1)]. Further, any distributions that are made by the ESOP to its nonresident beneficiaries are not subject to Indiana adjusted gross income tax pursuant to Rule 45 IAC 3.1-1-7 which provides that income distributed by a "qualified" pension, annuity, profit sharing or stock option plan to an individual are to be taxed by the state of legal residence of the individual. In the instant case then, the distributions and/or credits from the taxpayer made to the ESOP do not fall within the ambit of IC 6-3-4-13.

ISSUE #2 – Ruling

The Department rules that the taxpayer is not required to withhold adjusted gross income tax from amounts it pays or credits to the nonresident ESOP as dividends or as its share of the undistributed taxable income.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this

ruling, a change in a statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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